

Property Tax Case Picks Up Momentum

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They say an avalanche can start with something as simple as a lone skier traversing down a ridge. One small section of snow pack gives way and the momentum carries with it larger chunks of ice and snow, causing a chain reaction. Unchecked, that chain reaction can sweep down a mountainside taking everything in its path.

We don't get much snow here in Orange County, but there is an avalanche of sorts that has begun to gain momentum, and is creating quite a rumble as it moves, not down Saddleback Mountain, but through the courts, reaching the doorsteps of the 4th District Court of Appeals as the County Of Orange vs. Robert Pool case. One man, Robert Pool of Seal Beach, is challenging the very basis on which the county calculates property tax increases from year to year. As word of his claim gets out, and as recent lower court rulings have supported his case, one man's appeal for a modest refund has snowballed into a movement of more than 4,000 similar appeals according to the county clerk's own records.

It's a movement that threatens to become an avalanche of property tax reform affecting thousands of taxpayers in the county, millions of dollars in refunds, and ultimately involving every county tax jurisdiction, as well as public agencies and special districts supported by property taxes across the state.

Pool didn't start out trying to create an avalanche. All he wanted back was what he calculated as a \$100.55 overpayment on his property taxes. But to get that he had to challenge the county tax assessor/collector's long standing policy of taxing many property owners in excess of the maximum 2 percent per year increase imposed by Proposition 13 back in 1978. Pool's claim is that the county assessor has been essentially making up for the lean years in which property tax increases could not be justified (because real estate values stayed flat or actually depreciated) by increasing annual assessments beyond Prop 13 limits and tacking them onto subsequent tax bills as those property values recovered. So the Prop 13 mandated 2 percent lid on property tax increases in the recovering years (generally 1997 forward) could become 4 percent, as in Pool's case, or 6, or 10, or in some cases 20 percent in a single year as the county attempted, to use the government's word, ³recapture² those lost increases due to a real estate slump, such as occurred in the mid 1990s.

It is a practice Pool, himself a tax attorney, has firmly maintained is unconstitutional.

³The language of the state constitution is not vague on this,² he said, ³Article XIII A (from Prop. 13) was passed to give relief to people who were being taxed out of their ability to own a home, and to give the taxpayer some reasonable expectation of his tax burden from year to year.² The relevant section, XIII A(b), Pool is referring to reads as follows: ³The full cash value base may reflect from year to year the inflationary rate not to exceed 2 percent for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced to reflect substantial damage, destruction or other factors causing a decline in value.²

Prop 13 goes on to say only when the property changes ownership or is substantially improved (involving the permit process) can the property be reassessed up to full current market values.

Otherwise, property tax increases may not rise in value more than a steady 2 percent per year from the base year, which usually means the year the home was purchased.

Superior Court Judge John Watson added momentum to the Pool's case by not only upholding his argument but also certifying the suit as a class action and requiring the tax collector to identify and notify all potentially ³harmed² parties (that is, property owners who overpaid assessment taxes above the 2 percent increase under the

³recapture² method). The notification requirement has been stayed, or postponed, by judge Watson pending the outcome of the upcoming appeals court decision.

If Judge Watson's rulings are upheld by the 4th District Court of Appeals in the coming months, Pool's snowballing nuisance to the county could indeed become an avalanche of a problem.

Upwards of half of the properties in the county have been subject to this hypertaxing recapture method, particularly in the years from 1997 to 2002. It is estimated that some 300,000 to 400,000 property owners and close to a half a billion dollars in potential refunds may be involved here.

George Weigand of Cypress is one such property owner who saw his assessment rise 12 percent in 2001 and another 5 percent in 2002. That's a \$1,700 overpayment. And he wants it back. He appealed for a refund with the assessor's office after reading about the pool case in the newspapers. ³I don't know if I'll ever see anything from this,² Mr. Weigand said. ³But I do want to go on the record and object to what they've done. I've lived in my home for the past 11 years and I just don't know what to expect from my property bill anymore.²

The intent of Proposition 13 and Proposition 8 that followed it was to provide some consistent and reasonable cap on the runaway property tax increases of up to 25 percent that infuriated, and in some cases devastated, taxpayers through the 1960s and '70s.

Standardizing the assessment rate at about 1 percent and putting a 2-percent cap on property tax increases from one year to the next under Prop 13, not only gave beleaguered taxpayers immediate relief, but was meant to establish a constant and gradual assessment increase relative to the value of their homes that they could come to expect and financially plan for. That's pretty much how it worked for taxpayers like Brian Kibler of Los Alamitos, who saw his property taxes rise nominally through the 1990s but within the 2 percent per year limit. His assessment remained flat through the real estate slump of the mid-1990s, and though he could have appealed for a reduced assessment at that time under Prop. 8, he didn't. But when property values began to recover in the late-1990s, and Mr. Kibler saw his property tax bill rise almost 11.86 percent in the 1999-2000 tax year, and another 6 percent on top of that the following year, enough was enough, he said.

³It was one thing not to see my property tax go down along with property values like I understood they were supposed to, but it's something else to see them jump over 11 percent in one year when the values start to go back up, and 6 percent on top of that the next year. That's just compounding the insult. What happened to 2 percent? I look at the numbers. I see the county fudging. And the fudging's always in their favor.²

Mr. Kibler has filed an appeal.

Brian Kibler and Goerge Weigand are just two of a growing segment of disenchanted taxpayers now numbering in the thousands who are demanding refunds under the county's recapturing method of assessment. There is no doubt that Prop. 13 changed the rules of the game, lifted a crushing tax burden from the property owner, and put a manageable lid on future tax increases.

Prop. 8 subsequently addressed the question of whether property taxes should follow declining property values downward.

But neither proposition addressed in specific language how tax increases would be treated in a recovering market, as was the situation in the late 1990s.

Would assessment increases continue to be controlled at no more than 2 percent over the previous year no matter what the real estate market did? Or follow rising property valuations back up to the trended ceiling, even if that meant 5-, 10- or 20-percent higher assessments than the previous year, essentially recapturing those revenue increases it could not collect through the declining years?

Orange County assessors, not surprisingly, chose the latter, broader interpretation.

³Returning to market cap,² Assessor Webster Guillory calls it, ³The county is allowed to increase assessments at any rate, as long as the value remains under the long-term Prop. 13 cap.²

Taking advantage of what he calls ambiguities in the original propositions, Guillory defends the practice of recapturing by citing the recommendations of a legislative task force convened by then Speaker of the House Willie Brown back in 1979.

In it an interpretation was fashioned out of a majority opinion favorable to the state that said it was the ³long-term² cap on property tax increases steadily rising at 2 percent per year from the base year the property was purchased that mattered.

Therefore, they said, any property depreciations and reduced assessments that might occur in lean years should be considered ³temporary,² and as market values rebound assessment increases may indeed be ³recaptured² beyond 2 percent in a given year as long as they remain under the steadily rising or ³trended long-term² 2-percent increases (see graph).

So, before the ink was dry on Article XIII A back in 1979, a determined legislature had already fashioned an interpretation that would blunt much of Prop 13's effect over time.

It's an interpretation that would come to be known and used by almost every assessor in every county in the state as the recapture method.

³Recapturing is justified under Article XIII A of the constitution,² said county treasurer and defendant in the Pool suit John Moorlach. ³It resolves a number of ambiguities in the original legislation and gives us some flexibility in assessing a property based on current market values.² That means, in effect, the assessor can raise taxes more than 2 percent in a given year as long as the increase remains under the ³long-term² compounded 2 percent cap.

But was that the intent of Howard Jarvis and Paul Gann when they carved Prop 13 out of a wilderness of governmental property tax excesses?

Nowhere in the initiative or its legislative component, Article XIII A, does the word ³temporary² appear, or the word ³recapture² for that matter. Nor does it say anything about ³returning assessment levels to market cap.² Even among the original members of the legislative task force that became the foundation upon which the recapturing method rests, there was a strong minority voice who opposed the official recommendation to the legislature that exceeding the 2-percent clause in Prop 13 was justified.

Original task force member and Board of Equalization official Larry Augusta stated in January 1979 ³the final Task Force recommendation is inconsistent with the language of Proposition 13. We believe the correct rule to be: In no case can an increase in assessed value exceed 2 percent of the previous year's enrolled assessed value.²

And as recently as August 1999, the county's own deputy counsel, Karen Prather, was asked to provide legal opinion on the Pool case. She responded in a memorandum saying that ³assessment by more than 2 percent appears to violate § the Revenue and Taxation Code and Article XIII A of the California Constitution.²

Yet, from its inception in 1979 as a legislative task force recommendation, the recapture method has been a working premise on which assessments have been based, not only here in Orange County, but all across the state.

³But if recapturing is so bad,² asks County Treasurer Moorlach, ³if it is in fact unconstitutional, why haven't any high profile watchdog groups like the Howard Jarvis Taxpayers Association stepped up to challenge it? It says to me silence is acquiescence. It says you're OK with it.²

It's true. Except for the occasional Don Quixote charging off on his own, no major player in 20 years has stepped forward to legally challenge the recapturing method.

But it is not true that such organizations have been silent.

John Coupal, president of the Howard Jarvis Taxpayers Association, responds, ³In our view, the language of Proposition 13 is not ambiguous, it is abundantly clear. 2 percent is 2 percent. These local governments have been pushing the envelope for a long time now at the taxpayer's expense. But we recognize this is a monumental issue and the political implications are significant. It will take the right suit at the right time to prevail against such an entrenched policy as this. We're watching the Pool case very closely as it goes to appeal. This could be the one.²

Robert Pool, who , started out asking for a \$100.55 refund, now is squared off against the county assessor and treasurer; a powerful board of supervisors who, to date, have authorized more than \$700,000 toward an appeals fund to fight Pool; county assessor associations across the state; and just maybe the entire state legislature. So what makes Pool think he can prevail on a tax issue all others before him have failed?

For one thing, he himself is a tax attorney, aligned with a firm that is backing him all the way. And as a tax attorney, he believes he can see through what he calls ³the smoke and mirrors of this recapturing scheme.² ³The fact remains,² he continues, ³You don't make policy bases on what the legislation doesn't say. What it does say is property taxes are to be limited to 2-percent increases from year to year.²

Timing is also crucial to the Pool case. Since about 1997, property values have been rising, and along with them the full impact of a tax recapturing policy is being felt by an ever larger circle of property owners.

Pool has studied the cases of hundreds of these taxpayers who, like him, claim they have been in some cases grossly overcharged through recapturing. And he knows there are thousands more (over 4,000 by the county's own estimate). With a 4-year statute of limitations on refund appeals, a growing number of disaffected property owners will be prompted to seek inclusion under Judge Watson's recent certification of the Pool case to class action status.

Finally, it was Judge Watson's ruling in favor of Pool that set the stage for the county's forthcoming appeal to the 4th Circuit Court. No previous challenge to the recapturing policy has ever reached that level of judicial review. Pool thinks that's a victory in itself.

Of course, there will be a tremendous amount of attention and pressure applied to the Pool case as it goes through appeal in the coming months. This case may even find its way to the State Supreme Court. County Treasurer Moorlach said, ³guaranteed.²

In that case it could be years before a final decision is rendered. One thing is for sure, though. Eyes on both sides of the argument are watching this case very closely as it moves through the courts.

From anxious taxpayers to county agencies across the state, everyone has a stake in the outcome.

Even municipal governments and school districts who are the recipients of much of that property tax money are also watching very closely to see if this snowball from hell will indeed become an avalanche that could engulf them too.

Next week: Part II: The politics of appeal, what an appellate decision striking down the recapture method would mean for property tax payers locally, and the far reaching impact on county agencies and districts.